

Fixed Income Markets : Current Environment and Outlook

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Macro Events

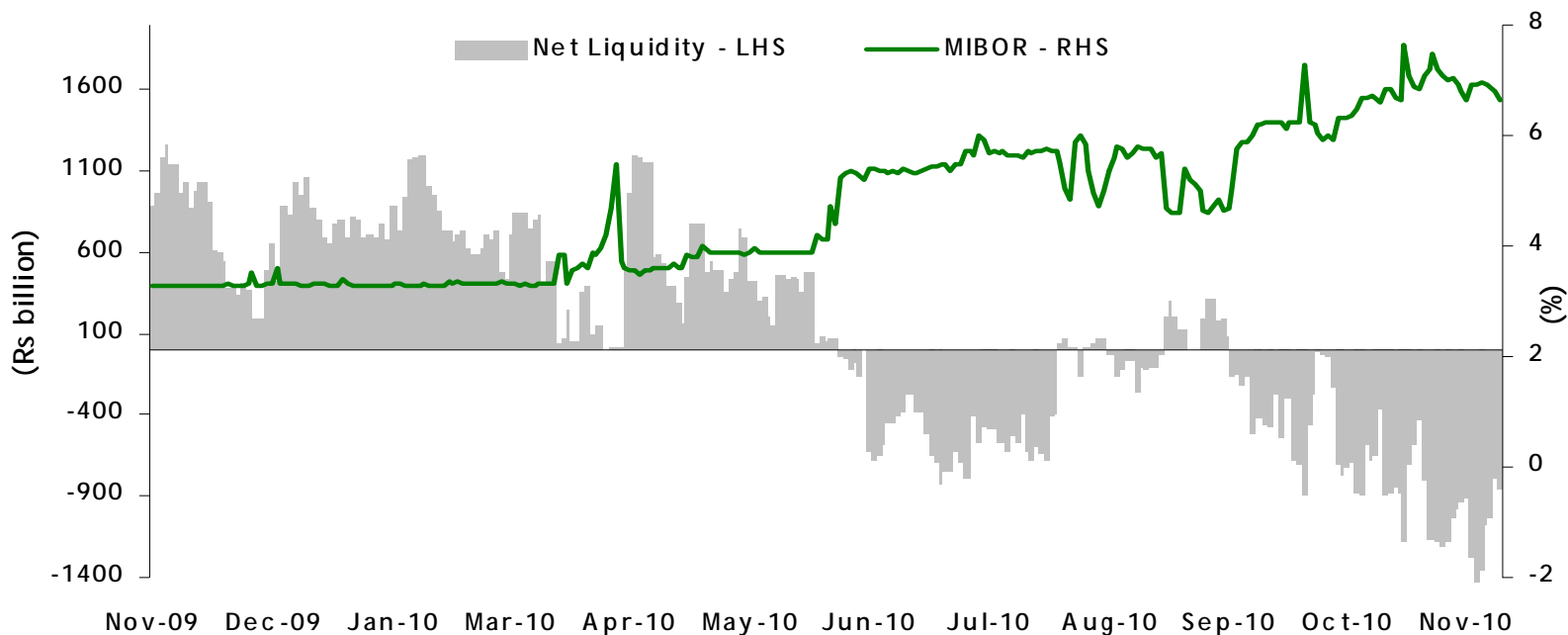
Domestic

- India's GDP grew 8.9% YoY in Q2FY11, well above consensus expectation, on strong manufacturing growth and farm output.
- Industrial production (IIP) plummeted to 4.4% YoY in Sep '10 (8.2% in Sep '09) from 6.9% in Aug '10. Capital goods sector saw the sharpest decline in production and contracted by 4.2%. However, on a cumulative basis in the first six months of FY11, IIP, remained in double digits at 10.2% as compared with 6.3% a year ago.
- The country's infrastructure sector output grew by an impressive 7% in Oct '10, against 3.9% in Oct '09, The six core industries — crude oil, petroleum refinery products, coal, electricity, cement and finished steel — had grown by 2.7% in Sep '10. The growth was propelled by a robust rise in cement production, crude oil and electricity generation which rose by 16.8%, 13.7% and 8.4%, respectively.
- Inflation, as measured by the WPI Index, fell slightly to 8.58% YoY in Oct 10, from 8.62% in Sep '10, according to the new WPI Index series with 2004-05 as the base year. Food Inflation was down to 14.1% from 15.7% in the previous month.

International

- Economic growth measured by GDP, rebounded marginally in the US, while growth momentum in the UK and the Euro zone remained subdued. The unemployment rate in the developed economies, however, continues to remain high.
- US GDP growth rate was revised marginally higher to 2.5% QoQ in Q3'10 rebounding from 2 consecutive quarters of decline and a 1.7% rate in Q2'10. GDP growth in the UK for Q3'10 rose by 0.8% QoQ and had been at 1.2% for Q2'10.

Liquidity - remains extremely tight



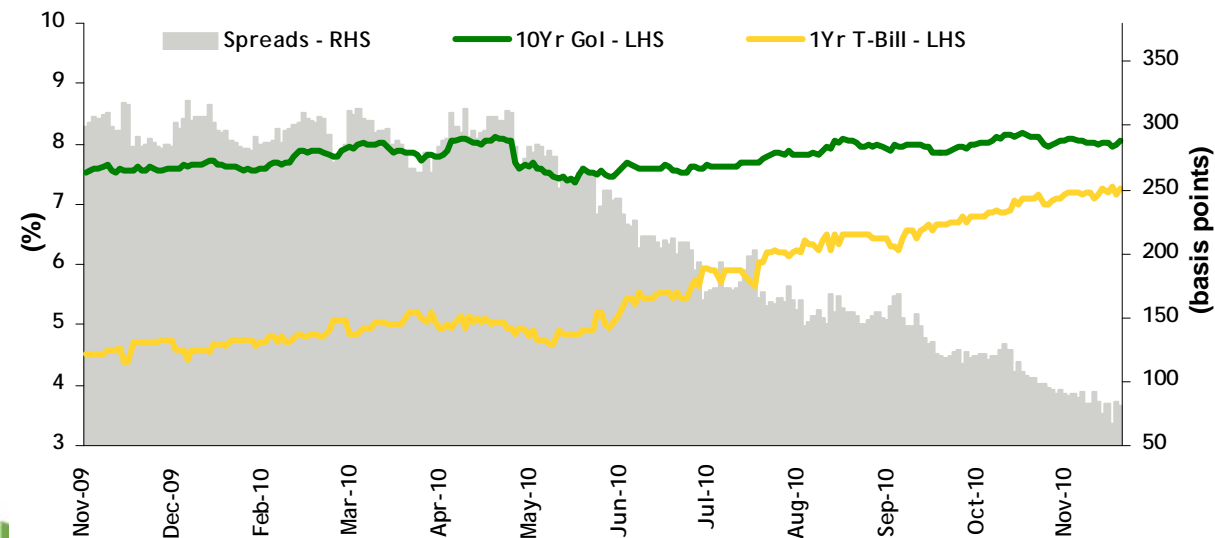
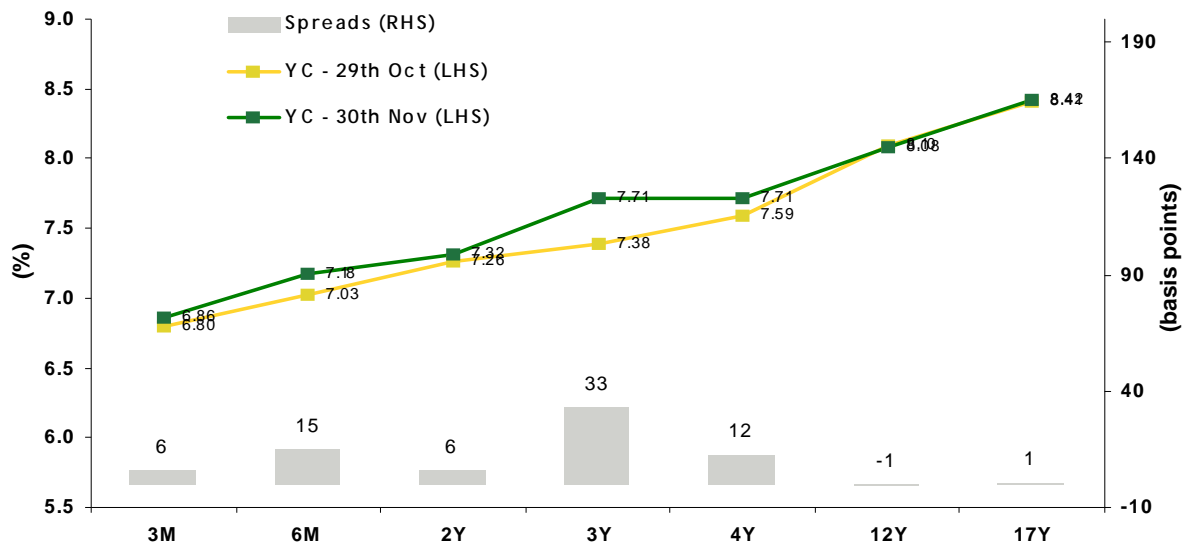
Source: Bloomberg

- Liquidity in the system continued to be tight over the month of November'10. The amount under the daily RBI LAF was around Rs 1 lakh crore.
- MIBOR rates went higher, averaging 6.96% over November '10, from 6.49% over October '10 amidst continuing tight liquidity



Source: Bloomberg

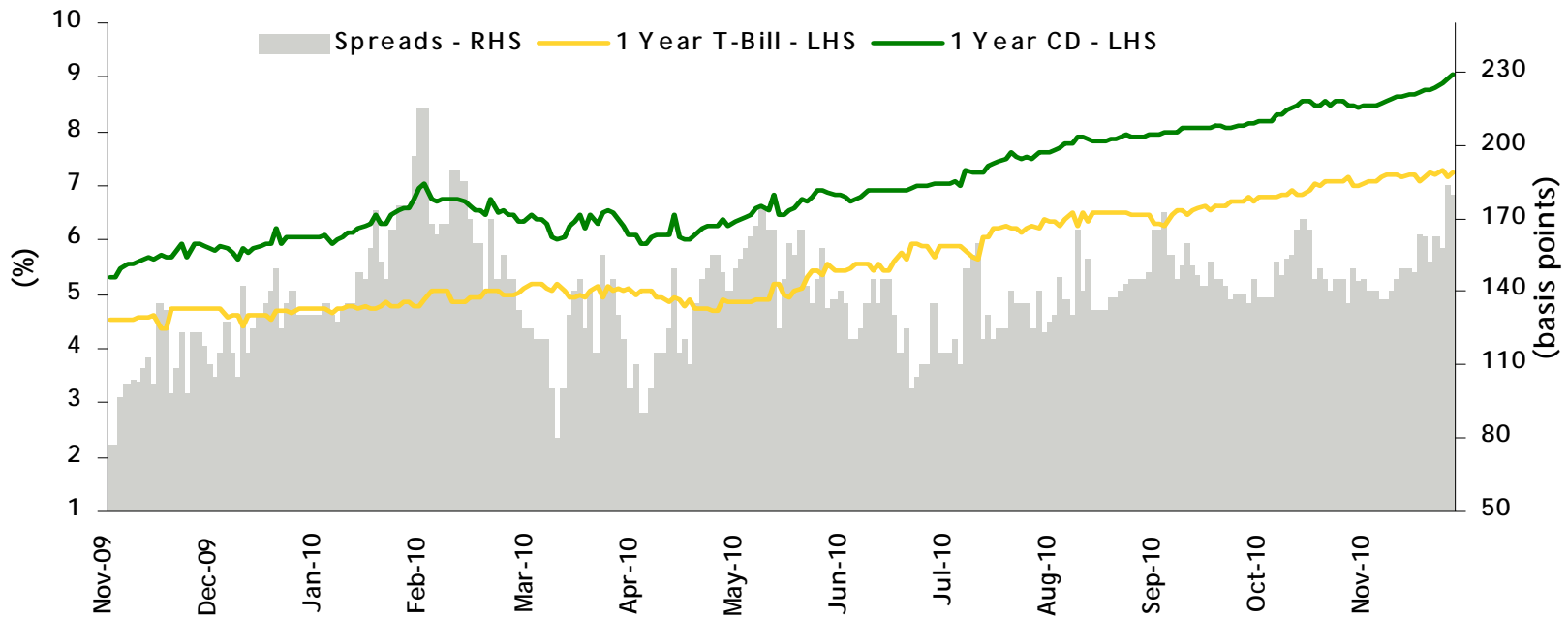
G-Sec Yield Curve - upward shift



- The G-Sec yield curve shifted upwards with yields on the short end of the curve rising the most followed by the yields on the long end.
- The yield on the 10yr benchmark rose 10bps over November'10 to 8.06%.
- In the latest T-Bill Auction, the 182-day T-bill was issued at 7.23% (7.05 in Oct'10) and the 364-day paper yielded 7.27% (7.09% in Oct '10).
- Current 10yr vs.1yr GOI spread fell to 80 basis points during November. The spread has averaged 217 bps during the last year



Money Market - rates remain high amidst tight liquidity



Source: Bloomberg

- Money market rates rose sharply in the month of November '10 amidst tighter liquidity in the market.
- Spreads between 1 Year CD's and T-Bill's ended November '10 at 180 bps while spreads between 1 Year CP's and CD's were 48bps. Overall, 1 Year CP's traded at a spread of 230 bps over 1 year T-Bills



Corporate Bonds spread - unchanged



Source: Bloomberg

- The 5 year AAA corporate bond credit spread over corresponding 5 year gilt remained unchanged over the month over November 2010.
- The spreads are averaging around 85 bp for the previous 4 months

Religare MF: Fixed Income Outlook and Opportunities

Fixed Income Market Outlook

- The general level of deficit liquidity over the month of December is expected to continue coupled with higher supply of primary papers and advance tax outflows from the system.
- The yields of short term papers are expected to harden further over the month.
- The trajectory of WPI inflation over the rest of the FY will determine several policy actions. The upward risks to inflation continue within the system.
- The rising cost of deposits within the banking space is posing a challenge.
- The yield curve at the longer end will continue to look for cues from the differential interest rates and movement in the international currency markets will largely determine the flow of currency.

Portfolio Actions during the month

- **Religare Liquid Fund**
 - The fund has maintained a low duration in line with the liquidity risk within the money market.
- **Religare Ultra Short Term Fund**
 - The Fund has also maintained a low duration of around 2-3 weeks in line with the liquidity risks within the market.
- **Religare Short Term Plan**
 - The fund has shortened the duration to around 9 months.
- **Religare Credit Opportunities Fund**
 - The fund has also shortened duration to around 140 days
- **Religare Active Income**
 - The duration is in line with the maturity profile of the liabilities.

Ideas for investors

- The shape of the current yield curve offers several opportunities depending on the investment horizon of the investors.
- The liquid and the ultra short term fund continues to be attractive for investors with very short investment horizon
- The sovereign yield curve offers superior opportunity for all investors with 1 year investment horizon.
- The credit opportunities fund is ideal for investors with around 3 months investment horizon and wants to align with the credit curve.

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